



Department of Homeland Security – US Coast Guard  
Notification of Findings and Recommendations (NFR)  
Fiscal Year Ended September 30, 2004

*Risk Factor - Medium*

**Location/Office:** Headquarters

**Finding number:** CG 04-010

**Audit Area:** Environmental Liabilities

**W/P Reference:**

**Date Provided to Management:** October 16, 2004

**Date Response Due:** October 21, 2004

**Title:** Environmental Liabilities – Shore Facilities

**Background:** At June 30, 2004, Coast Guard's estimated FY 04 environmental liability totaled \$103 million. Approximately \$64 million or 63 percent was associated with 185 shore facility projects.

**Condition:** Coast Guard's process for calculating its environmental liability associated with shore facilities was not fully effective. A review of 26 projects, with an estimated liability of \$34 million, disclosed that:

- Estimates were not always based on current-year dollars: Many estimates had not changed appreciably since FY 2003, and there were no indications that indexing (such as the consumer price index, or the rate of inflation) had been applied to bring prior-year estimates to current year dollars. Of the 26 projects reviewed, KPMG personnel determined that the estimated cost was understated by approximately \$405,000. KPMG personnel further determined that updating all estimates to current year dollars for the remaining 159 projects would increase the liability by an additional \$357,120.
- There was inconsistent use of contingency factors: Many uncertainties exist with estimating the cost including the various methods of remediation that may be required and the costs of long-term monitoring. Develop of the cost estimate is even more difficult in the early stages of a project when the complete exposure and related remediation is still under evaluation. To compensate for these uncertainties, it is common to apply a contingency factor to the cost estimate, which pursuant to Coast Guard's policy, is typically 5 to 10 percent of a project's estimated cost. However, the Coast Guard did not apply a contingency factor to similar cost estimates on a consistent basis. Of the 26 projects reviewed, KPMG personnel determined that the estimated cost was understated by approximately \$730,000. KPMG personnel further determined that updating all estimates to current year dollars for the remaining 159 projects would increase the liability by an additional \$645,229.
- Errors in the original calculations caused an overstatement of \$8.3 million.

**Criteria:** Statement of Federal Financial Accounting Standards (SFFAS) Number 6, *Accounting for Property, Plant, and Equipment*, paragraph 85 defines environmental cleanup costs as those costs for removing, containing, and/or disposing of (1) hazardous waste from property, or (2) material and/or property that consists of hazardous waste at permanent or temporary closure or shutdown of associated PP&E. Paragraph 88 states that these cleanup costs meet the definition of liability provided in SFFAS number 5, *Accounting for Liabilities of the Federal Government*. In addition, SFFAS number 6 paragraph 96 states that remediation estimates shall be revised periodically to account for material changes due to inflation or deflation and changes in regulations, plans and/or technology. New remediation cost estimates should be provided if there is evidence that material changes have occurred; otherwise estimates may be revised through indexing.

ISO 14001 standard specifies requirements for establishing an environmental policy, determining environmental aspects and impacts of products, activities, and services, planning environmental objectives and measurable targets, implementation & operation of programs to meet objectives and



**United States Coast Guard**  
**Fiscal Year 2003 Audit**  
**Notification of Findings and Recommendations (NFR)**

targets, checking and corrective action, and management review. The ISO 14001 standard requires documented procedures that are implemented and maintained in such a way that successful achievement of environmental goals commensurate with the nature and scale of activities is facilitated. In addition, the EMS must include appropriate monitoring and review to ensure effective functioning of the EMS and to identify and implement corrective measures in a timely manner. The ISO 14001 standard requires that procedures be established for ongoing review of the environmental aspects and impacts of products, activities, and services. Internal audits of the EMS must be conducted routinely to ensure that non-conformances to the system are identified and addressed. In addition, the management review process must ensure top management involvement in the assessment of the EMS, and as necessary, addressing the need for changes. The Coast Guard Yard has implemented the International Organization for Standards (ISO) 14001 standard, *Environmental Management Systems* (EMS). At several other locations, the Coast Guard had implemented ISO 14001 standard-like programs.

The *Federal Managers' Financial Integrity Act of 1982* requires "internal accounting and administrative controls of each executive agency shall be established in accordance with standards prescribed by the Comptroller General."

GAO's *Standards for Internal Control in the Federal Government* defines internal control as "an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations." In addition, the *Standards* state that management is responsible for developing and documenting detailed policies, procedures, and practices that fit their agency's operations and as part of their monitoring of internal control, management must continue to maintain these policies and procedures and assess the quality of performance over time.

*Standards for Internal Control in the Federal Government* list five standards for internal control, to include monitoring. The standards further state "internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continually and is ingrained in the agency's operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties."

**Cause:** Lack of policies or procedures, or failure to follow stated policies and procedures, resulted in different approaches by shore facility commands in calculating the environmental liability estimates.

**Effect:** The environmental liability associated with shore facilities is understated. The understatement ranged from \$19 to \$23 million.

**Recommendations:** We recommend that the Coast Guard:

1. Develop and implement policies and procedures to apply indexing and contingencies to environmental estimates on a consistent basis.
2. Develop and implement a process to estimate the environmental liability regardless of funding source.
3. Consider implementing ISO standard 14001, consistently across the Coast Guard and specifically at those units responsible for significant environmental remediation projects.

**Management Response:**

KPMG policy requires that we obtain your response to this notification of finding and recommendation in writing. As such, please indicate your response by checking the appropriate box below and providing the appropriate supporting documentation to KPMG within five business days



**United States Coast Guard**  
**Fiscal Year 2003 Audit**  
**Notification of Findings and Recommendations (NFR)**

from the date of this notification. Your written response will be considered when preparing the draft consolidated audit report.

- ☒ Management concurs with the Notification of Finding and Recommendation and has provided a corrective action plan, with milestone dates, developed to address the condition in the space provided below or as an attachment to this document. (Note: Responses should not be delayed until plans are finalized. If plans are not complete, specify a completion date when forwarding your responses.)
- ☐ Management does not concur with the Notification of Finding and Recommendation and provided further detail supporting our position in the space provided below or as an attachment to this document.
- ☒ Corrective action will be taken and completed in current fiscal year (check box if "yes").

***General Comments***

***Corrective Action Planned***

The CG will issue guidance to the MLC's on the application of contingency factors for estimates of shore facility environmental liabilities and develop a process to include liability estimates regardless of funding source. The CG is in the process of implementing environmental management systems (EMS) at 16 large units. More are planned when funding becomes available. They will follow either ISO 14001 or similar type federal standards.



United States Coast Guard  
Fiscal Year 2003 Audit  
Notification of Findings and Recommendations (NFR)

KPMG Response, if Necessary: (See GAGAS paragraph 5.30)

1.

Bruce Antiporowich  
Senior Manager, KPMG LLP

September 22, 2004

Date Provided to Management

2.

CAPT Jay Manik  
Chief, Office of Civil Engineering

3.

CAPT Larry White  
Chief, Office of Financial Policy

Date Response Received from Management